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IN THE

# Supreme Court of the United States

October Term, 1965
No. 487

WILLIAM MALAT and ETHEL MALAT,

*Petitioners,*

*vs.*

ROBERT A. RIDDELL, District Director of Internal Revenue,

*Respondent.*

## PETITIONERS' REPLY BRIEF.

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*Petitioners,*

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ROBERT A. RIDDELL, District Director of Internal Revenue,

*Respondent.*

## PETITIONERS' REPLY BRIEF.

### A. Examination of Respondent's Statement.

Respondent argues a case, but not this case. His statements as to the significant, critical facts misrepresent the record so vitally and so baldly that his arguments based upon them have no relevance whatever to to the questions presented here, even as respondent has tendentiously framed those questions. We show now the more serious of these misrepresentations.

1. On page 3 respondent points out that, during the five years prior to the year here in question, 1956, Lesser Enterprises had participated in, *inter alia,* "the construction and rental of over 300 duplex apartments and homes", but he fails to observe that at the time of trial, 1964 [R. 37], more than *eight years* later, Lesser Enterprises still owned them and still rented them [R. 75].

Also, at the same page respondent points out that Lesser Enterprises participated in "the organization of at least two shopping centers", but fails to state that they were holding their interests in the said shopping centers for income [R. 39].

Also, at the same point respondent refers to "at least five separate sales of unimproved, bulk land", giving details in a footnote, but fails to state that two of those sales were the very sales involved here.

2. On page 4 respondent refers to petitioner Malat's interest in Lesser Industrial Properties, "which purchased land and constructed warehouses, factories, and similar industrial facilities for rental", but fails to note that the buildings were held *only* for lease, and were being leased on a fairly long-term basis [R. 39].

3. On page 5 respondent says, in reference to the property involved here, "There is some dispute about the purpose for which the venturers acquired the property." In support of this he says petitioner testified "that the property was in a 'fast-growing area' and the venturers hoped to obtain sufficient financing at favorable terms to construct a 'major apartment project' on it," [citing R. 42, 118]. But, he says, petitioner also "testified that the mortgage market had been 'rough' and they realized there was a substantial possibility that they might be unable to get 'financing that would permit us to * * * get what we felt was a reasonable return on our equity investment,' in which case they would sell the land if that was more profitable" [citing R. 83-84, 118, 116, 100]. Basing on those two facts the idea of a dispute in the evidence is a not very subtle misrepresentation of the record.

(a) In the first place, as shown by R. 42, the statement that the venturers hoped to obtain sufficient financing at favorable terms to construct a major apartment project relates to a hope held by them before escrow was opened. Indeed, as shown by R. 46, exploration of the mortgage market in respect to the particular property was not begun until escrow was opened and the property tied up. But the page in the record which contains the wording subquoted above beginning with the word "financing" [R. 118], refers to a determination made by the venturers after such exploration, indeed, several months after close of escrow. It could hardly therefore contradict hopes of the venturers before they opened escrow, or show a dispute about the purpose "for which the venturers acquired the property".

(b) In the second place, the purpose "for which the venturers acquired the property", as brought out by the trial court, is nowhere controverted. We quote, R. 86:

> "The Court: All right. When you bought the property originally, the 49 acres, you had in mind developing the entire 49 acres under this FHA project which called for more than four units.
>
> "The Witness: Well, the entire project less any portion that we might have indicated to us could possibly be zoned commercially, because commercial has more value to us."

[See also R. 42]. Nowhere in the record is there anything in conflict with this.

(c) In the third place, respondent (although it was he who, after petitioners' opening brief had been filed,

had the exhibits in the case added to the record here, as to which petitioners made no objection) failed to quote from Exhibit 5, the venturers' agreement dated August 12, 1953, on which he otherwise relies (Br. 5), the following statement, on page 2, of the venturers' original purpose:

> "to own, hold, manage, improve, develop, and operate the real property to the benefit of the joint venture";

and the provision, on page 6, that the agreement "shall continue in full force and effect for a period of thirty (30) years from the date hereof."

(d) In the fourth place, and still more significantly, there is absolutely not a word to support the wording of respondent quoted above, from his page 5, "in which case they would sell the land *if that was more profitable.*" (Italics supplied). We mean there is not a word to support this not only in the pages there cited by respondent [R. 83-84, 118, 116, 100], but in the entire record.

(e) Finally, in his very next sentence, in an obviously desperate attempt to support the wording above italicized as to why the joint venture of which Lesser Enterprises was a member bought the property, respondent quotes from R. 100 a neatly carved out portion of the testimony of Fenmore as to why, as that page clearly shows, he and Hicks *bought it from* the joint venture.

In summary under this point 3, it can be seen that there is no dispute and no doubt as to the purpose for which the venturers acquired the property, and that the purpose was strictly investment. The possibility that

they might "sell the whole thing off in bulk" *so they wouldn't get hurt* [R. 22], if their investment plans could not be carried out, does not conflict with a purpose of investment as the primary purpose for which the property was held. On the contrary, we submit, it confirms that purpose. It was but the logical and normal course for saving the investment from loss.

4. On page 6 respondent says that the venturers explored the possibility of getting financing to construct buildings containing about 1000 apartments, but were unable to get "financing at terms that would have permitted them *the profit* they expected." (Italics supplied). But the pages cited by respondent show nothing whatever about a *profit* that was expected. What they show is that the venturers were unable to get "financing that would permit [us] to build apartments for rent and get what we felt was a reasonable return on our equity investment." This, moreover, was in relation to the frontage properties [R. 118], after the inner portion had been subdivided and sold. Respondent keeps on inserting the word "profit", everywhere, to suggest the idea of a holding for sale, despite the complete and total absence of any support for this anywhere in the record.

5. In a footnote on page 7 respondent says that Mr. Fenmore "testified that there was no serious disagreement between the venturers until *after the sales here in question.*" (Italics supplied). Respondent cites for this R. 99-101. But he fails to note, at R. 101-102, the testimony of the same witness, who was respondent's own witness, and which was based on a deposition of him taken by respondent. That testimony shows that when the said sales occurred the disagreement be-

tween the venturers already existed, that at that time the "personal relationship" of the venturers "was not a happy one." We quote from that testimony, p. 101:

> "A. Well, I think it goes much further than that. We were not happy with the other people, especially Lesser, and we made the partnership an offer of a substantial price for the land and said either the land should be sold to somebody else or sold to us.
>
> "I can only go back to say it was not a pleasant period in our relationship and that is the way it ended up."

That testimony is plainly consistent with the testimony of Mr. Malat [R. 79-80], that the partnership began to fall apart about four months before those sales, and his testimony brought out by the trial court, quoted in our opening brief, pp. 7-8, showing that the dispute was the sole reason for those sales. We emphasize this only because this effort of respondent to show that the venturers were in peace and harmony when these sales were made is part and parcel of his effort to support his fiction that there was a profit motive in the sales.

### B. Examination of Factual References in Respondent's Argument.

The attempt of respondent to misrepresent the record before this court is continued and pressed in his argument. We show again the more serious of such misrepresentations.

1. Thus, in the title on page 12 of his brief, and again on page 25 of his brief, respondent repeats as to the facts his wholly false "more profitable" thesis re-

ferred to in point 3(d) above. Also on page 25, in an even more ill-adorned form, he restates the misrepresentation shown in point 3(e) above. Respondent there says that the price at which the venturers "had acquired the property gave them 'a chance to make a very substantial profit on the sale or sales', either by subdividing or selling in bulk or some combination thereof" [citing R. 100, 116]. The subquoted words, of course, as the cited pages show, relate only to the purchase by Fenmore and Hicks *from* the joint venture; they have no connection, not even the remotest, with the acquisition of the property in the beginning *by* the joint venture.

2. On the next page, 26, respondent embellishes the above misrepresentation by saying that the offers from Ponty and Hicks-Fenmore were the "best offers". But the record nowhere shows any other offers. In the next sentence respondent says the venturers went into discussion to determine "whether to accept these offers *or seek additional buyers*" (Italics supplied). But the record is completely wanting in anything to show consideration of seeking additional buyers, or seeking any buyers at all.

3. At the same point respondent seeks to draw an admission from the venturers' reporting of the gains on the inner portion as ordinary income. But the sales of the inner portion, as the Court of Appeals pointed out, R. 30, resulted from the need for funds to pay interest charges and other costs. Despite that, they reported those gains as ordinary income. This represents no admission as to the purpose, after selling the inner portion, for holding the frontage parcels, for as the

Court of Appeals there observed, "The frontage parcels were retained, still in hope that commercial zoning could be secured as to them." [R. 30]. Clearly, what the venturers saw was ordinary income on the inner portion because it had been subdivided. Whether they were right or wrong on that is not before this court; only the frontage parcels are here involved.

4. On page 29 respondent says that the venturers sold the property to Hicks-Fenmore "only because it made a better offer than the other available buyers." This is a repetition in slightly different words of the misrepresentation of the record with the words "best offers" referred to in point 2 above.

5. On page 32, as at least at a dozen prior points in his brief, respondent refers to the 9-month period of holding, being the nine months between the close of escrow and the sales involved. Nowhere does he note that the close of escrow was a full 6 months after opening, and that in the meantime, as the summary of the Court of Appeals shows [R. 29], because of their investigations "the intentions of the venturers with respect to the land had undergone a series of changes." Not that the position of petitioners is so much better because the actual period involved was 15 months instead of 9, but that this is just part of respondent's studied and unremitting effort to distort and make over into his own image the record before this court.

6. Finally, on the same page, page 32, respondent attempts to attribute the gains on the frontages to an increase in value resulting from the subdivision of the inner portion. But there is no evidence whatever in support of this. The very pages cited by respondent show

[R. 42] that it was a "fast-growing area", [R. 114-115] that these increases could result from any subdivision in the area, and that subdivision in the area could instead depress the value, depending on the total situation. And we ask this court to take judicial notice of the rapid growth during the past decade and more in the entire Los Angeles area. Fifteen months is a long time from that standpoint in Los Angeles.

### C. Reply to Respondent's Argument.

Respondent makes no effort to answer petitioners' contentions; throughout his argument he sets up other contentions as straw men which he attacks. We shall of necessity deal with them accordingly.

#### I.

Respondent's first proposition (Br. 12), is that a person who purchased an asset "for either rental or sale in the ordinary course of his business, whichever is more profitable," is not entitled to have "his regular business profits from its sale taxed as capital gains." But this is not our case.

He begins under that proposition with the assumption, (Br. 13), that a person in the real estate business cannot possibly hold a piece of real estate as an investment. But the very facts here brought out by respondent himself, amplified above, show that their major properties were held as investment. That a person who holds real estate for sale to customers in the ordinary course of trade or business can also hold real estate as investment, even a part of the same parcel, is beyond question. Respondent has himself so ruled (Rev. Rul. 57-565, 1957-2 C.B. 546, cited in petitioners' opening brief,

p. 15). Real estate is a common subject of investment. It is the same as with a person in the securities business.

Respondent's authorities on this point have no pertinence at all. They include (Br. 15-21), houses constructed for lease with option to purchase; coolers, microfilming equipment, automobiles, et cetera, held for rent or sale; corn futures held for inventory support; and consideration received for temporary seizure of property, income from oil and gas leases, consideration for cancellation of a lease, the excess received for delay in connection with an award for property, consideration for an unmatured crop, and the excess received over issue price on non-interest bearing promissory notes. The sales involved here have no sensible connection with any of those situations.

We do not contend that a person who holds property for rent or sale in the course of his day-to-day business operations, as in the very common case of persons in the business of leasing equipment with option to buy, can claim capital gain on the sales. The same situation in connection with real estate is entitled to no different treatment. In every such rent-or-sell case there is a course of sales which is an inseverable part of the taxpayer's day-to-day business operations. Indeed, the rental in such cases is hardly more than an initial stage or variant of a sale. We covered this point clearly in our opening brief, at page 16.

But this has nothing whatever to do with the situation here. In this connection we quote from a deposition taken by respondent and *read into the record by respondent,* at [R. 118]:

> "Incidentally, even at that time [when the offers for the two frontage pieces involved here were received], we were not offering those properties for sale; the Crenshaw or the Century properties. They were not listed with brokers. They were not advertised for sale. They were not being offered for sale."

It is impossible, as of any point of time, no matter how imaginatively the record is read, to give a rent-or-sell cast to those two pieces of property, as they were, or as they were planned to be improved. We say here again, as in reference to respondent's other carefully designed distortions of the record, he is arguing a case, but not this case.

II.

As his second proposition respondent contends that the lower courts found "that one of the essential or substantial purposes for holding the property was for sale to customers in the ordinary course of business;" but even if there were such a finding, which there was not, it is not sufficient.

We submit again that a finding "that one of the essential or substantial purposes for holding the property was for sale to customers in the ordinary course of trade or business", is insufficient for denial of the gain

as capital gain. No such finding was in fact made, by either court below; but we assume for the purpose here that it was.

The statute requires that the property be held *primarily* for sale to customers in the ordinary course of trade or business. The word "primarily" is not a word of art; it is a word of common, everyday use. So is "substantial," and very clearly they do not mean the same thing. Nor is there anything in the statute here from which it can be concluded that Congress, by the word "primarily", meant anything but "primarily".

Perhaps respondent's effort here, however, is spelled out in his statement at page 19 of his brief, where he states: "Congress certainly did not intend to convert a taxpayer's regular business profits into capital gain merely because he both rented and sold the same *type* of asset." (Italics supplied). What respondent is saying there is that if a person holds any real estate for sale to customers in the ordinary course of his trade or business, then he cannot get a capital gain on *other* real estate even though it is held for rental only, without any intention to sell. Even the rent-or-sell doctrine does not go that far. Certainly there is nothing anywhere in any statutory provision to support this.

In a footnote (Br. 27), respondent tries still another idea. He cites there 1954 Code §702(b), which says that the character of an item on a partner's return is to be determined as if it had been realized directly from the source from which realized by the partnership. But respondent cites it for the proposition that: "If the joint venture which held the land was in the real estate business, all of the venturers' gains on the sales here in

question would be taxable as ordinary income." This is a wholly different proposition. There is nothing in the cited statutory provision, nothing whatever, which by any possibility can be interpreted as saying that.

By way of summary, it is obvious that what respondent is really trying to do is to reach the subconscious of this court. Respondent repeats and repeats suggestive phrases. For example, there are forty-two places in the brief where respondent uses the phrase "ordinary course of trade or business," or equivalent phrases such as "normal course of business" and "everyday operation of business." There is also obvious an attempt to confuse the court, to entangle it by constant repetition of irrelevancies, and to prejudice the court by constant repetition of phrases having no connection with the facts, and tying together as if spoken in one breath, different portions of the testimony relating to different periods and different subjects. It is not the mind of the court to which respondent's brief is directed but to its subconscious.

## Conclusion.

We submit in conclusion that the courts below have clearly erred and should be reversed.

Respectfully submitted,

GEORGE T. ALTMAN,
*Attorney for Petitioners.*

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# SUPREME COURT OF THE UNITED STATES

No. 487.—October Term, 1965.

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| William Malat et ux., Petitioners, *v.* Robert A. Riddell, District Director of Internal Revenue. | On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit. |

[March 21, 1966.]

Per Curiam.

Petitioner was a participant in a joint venture which acquired a 45-acre parcel of land, the intended use for which is somewhat in dispute. Petitioner contends that the venturers' intention was to develop and operate an apartment project on the land; the Commissioner's position is that there was a "dual purpose" of developing the property for rental purposes or selling, whichever proved to be the more profitable. In any event, difficulties in obtaining the necessary financing were encountered, and the interior lots of the tract were subdivided and sold. The profit from those sales was reported and taxed as ordinary income.

The joint venturers continued to explore the possibility of commercially developing the remaining exterior parcels. Additional frustrations in the form of zoning restrictions were encountered. These difficulties persuaded petitioner and another of the joint venturers of the desirability of terminating the venture; accordingly, they sold out their interests in the remaining property. Petitioner contends that he is entitled to treat the profits from this last sale as capital gains; the Commissioner takes the position that this was "property held by the taxpayer

primarily for sale to customers in the ordinary course of his trade or business," [1] and thus subject to taxation as ordinary income.

The District Court made the following finding:

> "The members of [the joint venture], as of the date the 44.901 acres were acquired, intended either to sell the property or develop it for rental, depending upon which course appeared to be most profitable. The venturers realized that they had made a good purchase price-wise and, if they were unable to obtain acceptable construction financing or rezoning . . . which would be prerequisite to commercial development, they would sell the property in bulk so they wouldn't get hurt. The purpose of either selling or developing the property continued during the period in which [the joint venture] held the property."

The District Court ruled that petitioner had failed to establish that the property was not held *primarily* for sale to customers in the ordinary course of business, and thus rejected petitioner's claim to capital gain treatment for the profits derived from the property's resale. The Court of Appeals affirmed, 347 F. 2d 23. We granted certiorari (382 U. S. 900) to resolve a conflict among the Courts of Appeals [2] with regard to the meaning of the

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[1] Internal Revenue Code of 1954, § 1221 (1), 26 U. S. C. § 1221 (1):

"For purposes of this subtitle, the term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

"(1) . . . property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

[2] Compare *Rollingwood Corp.* v. *Commissioner*, 190 F. 2d 263, 266 (C. A. 9th Cir.); *American Can Co.* v. *Commissioner*, 317 F. 2d 604, 605 (C. A. 2d Cir.), with *United States* v. *Bennett*, 186 F. 2d 407, 410–411 (C. A. 5th Cir.); *Municipal Bond Corp.* v. *Commis-*

term "primarily" as it is used in § 1221 (1) of the Internal Revenue Code of 1954.

The statute denies capital gain treatment to profits reaped from the sale of "property held by the taxpayer *primarily* for the sale to customers in the ordinary course of his trade or business." (Emphasis added.) The Commissioner urges upon us a construction of "primarily" as meaning that a purpose may be "primary" if it is a "substantial" one.

As we have often said, "the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses." *Crane* v. *Commissioner*, 331 U. S. 1, 6. And see *Hanover Bank* v. *Commissioner*, 369 U. S. 672, 687–688; *Commissioner* v. *Korell*, 339 U. S. 619, 627–628. Departure from a literal reading of statutory language may, on occasion, be indicated by relevant internal evidence of the statute itself and necessary in order to effect the legislative purpose. See, *e. g.*, *Board of Governors* v. *Agnew*, 329 U. S. 441, 446–448. But this is not such an occasion. The purpose of the statutory provision with which we deal is to differentiate between the "profits and losses arising from the everyday operation of a business" on the one hand (*Corn Products Co.* v. *Commissioner*, 350 U. S. 46, 52) and "the realization of appreciation in value accrued over a substantial period of time" on the other. (*Commissioner* v. *Gillette Motor Co.*, 364 U. S. 130, 134). A literal reading of the statute is consistent with this legislative purpose. We hold that, as used in § 1221 (1), "primarily" means "of first importance" or "principally."

Since the courts below applied an incorrect legal standard, we do not consider whether the result would

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*sioner*, 341 F. 2d 683, 688–689 (C. A. 8th Cir.). Cf. *Recordak Corp.* v. *United States*, 325 F. 2d 460, 463–464 (Ct. Cl.).

be supportable on the facts of this case had the correct one been applied. We believe, moreover, that the appropriate disposition is to remand the case to the District Court for fresh fact-findings, addressed to the statute as we have now construed it.

*Vacated and remanded.*

MR. JUSTICE BLACK would affirm the judgments of the District Court and the Court of Appeals.

MR. JUSTICE WHITE took no part in the decision of this case.

END